

**THE FIGHT AGAINST CORRUPTION, MONEY LAUNDERING AND THE
FINANCING OF TERRORISM.**

A presentation on Wednesday, 29 March 2006, to the House Committee on International Relations, Subcommittee on Oversight and Investigations.

My name is Rodney M Gallagher OBE. I am currently a partner in Gaffney, Gallagher & Philip of Miami, Florida.

Thank you for the opportunity to be here today.

Over the last fifteen years I have been an observer of the issues related to corruption, money laundering and terrorism financing, as viewed through the window of offshore financial services jurisdictions, mainly in the Caribbean Basin.

In my role as Financial Services Adviser to the British Government I had a hand in the establishment of mechanisms to deal with the problem of concealing the proceeds of serious crime. As sole Commissioner I examined corruption related to a public sector project in the British Virgin Islands and as Chief Investigator I am assisting currently the Commission of Inquiry related to fraud on a large public sector project in St Vincent & the Grenadines.

My work with the British Government involved me, first hand, in the investigation of a number of instances of the laundering of the proceeds of corruption and other serious crimes, including drugs trafficking, through offshore financial services jurisdictions, mainly in the Caribbean.

I am currently a partner together with Ross Gaffney and Paul Philip, both formerly with the FBI, in the firm of Gaffney, Gallagher & Philip of Miami, Florida. We undertake financial investigations, asset recovery and security work across the US and the Caribbean.

Corruption

Let me begin with a brief overview of corruption in both the public and the private sector.

It is curious that we use the word corruption to describe an act that may be much more straightforwardly described as "theft". It is only the ancillary aspects of the theft that give rise to the need to use the word corruption. And the most distinctive ancillary feature is the conspiracy that always underlies corruption. More than one criminal is always involved in corruption.

Corruption applies equally to the private sector as it does to the public sector; but the private sector is far less disposed to launch a public inquiry and we therefore see far less of the problem. And in the private sector the key issue is recovery of the money, rather than a criminal prosecution. The private sector is always concerned that the circumstances that give rise to corruption indicate weak or failed management systems, which might be view amongst the shareholders as systemic and likely to affect the share value. There are strong incentives therefore to conceal the crime. We often only see private sector corruption when the matter is the subject of a criminal prosecution.

In the public sector most inquiries in to corruption have a political dimension, usually a new government elected on a mandate to "clean up" an earlier, allegedly corrupt regime. But even in the public sector there are strong motives to conceal corruption, even when it is detected, as once again it may indicate weak systems.

Both the public and the private sector efforts to deal with corruption face the problem of the conspiracy that always underlies any corrupt act. The conspiracies are seldom simple, and the relationships that support them are usually complex. Contrary to the popular view, few instances of corruption involve direct payments between the person making the request for a benefit and the person who can grant the benefit, although such crude examples do occur.

For example, there were allegations a year or two ago relating to the payment by a Swiss based individual to the Prime Minister of Grenada of US\$500,000 in cash, caught on the security video of the house in Switzerland. The Swiss based individual claimed that the payment was for the grant of an Honorary Ambassador position. The Prime Minister acknowledged receiving cash but claimed it

was only US\$15,000. Despite the relative simplicity of these allegations it proved almost impossible to bring criminal charges against either of the parties concerned.

Where more complex, indirect benefits are provided, often through the actions of an unrelated third party, it is even more difficult to establish a criminal case. Here in the US you need look no further than the Volker Report on the UN Oil for Food programme. Financial intermediaries, banks and family friends, all may act to obscure the flow of benefits, which may sometimes even be in kind, or in the form of a negative action. Often simply forgetting to do something can be a benefit.

Frequently the structures that support the corruption and launder the proceeds are controlled at the very highest level of government. In the Ukraine President Lazarenko not only received huge amounts of money from foreign and local ventures he established his own bank in Antigua to handle the money, working through a number of third parties in Switzerland and the USA. At the time few people in the banking community knew of his involvement and those who were acting on his behalf did so with all the power of the state behind them.

What is being done about the problem?

The international community has recognised the problem. There is a UN Convention that seeks to address the issue.

On the laundering of the proceeds of corruption the Financial Action Task Force has led the way in raising concerns about role of politically exposed persons in the financial sector. But may not have gone far enough.

FATF only seeks to address the problem of "foreign" politically exposed person, not domestic ones. This means that a bank, or other financial institutions will only give special attention to a foreign person, asking the question, "are you a politically exposed person, or are you related to one". Such an approach that concentrates only on the foreign PEP, flies in the face of all commonsense and appears to be window-dressing by FATF.

Indeed the entire FATF approach is designed only to avoid the problem of the proceeds of corruption flowing in to financial institutions in FATF member countries, not to strike at the real causes of the problem.

Various Governments and international bodies such as the World Bank have incorporated in to their overseas aid

programmes criteria related to "good governance". At the margin these efforts are effective in limiting or denying aid flows to some countries. But anyone who understands that aid flows are only a tool of international relations will quickly appreciate that criteria related to good governance will often be over-looked in the wider interests of the donor state. There are very few countries that can claim a wholly ethical foreign policy approach.

Money Laundering

In considering money laundering in offshore jurisdictions it is necessary to understand that almost all the transactions involved originate in, or flowed through the financial sector of the major developed countries, New York, London, Tokyo and Frankfurt.

The role of the offshore sectors is largely at the layering stage of money laundering, placement having been done in a major financial market, where it is easier to conceal a large transaction.

For example, in the case of Montesinos, the Peruvian Head of Intelligence, very large sums of cash were entered in to the banking system in the US, Europe and the Far East before being routed to secret bank accounts in the Cayman Islands, Aruba and Curacao and then back to accounts in the USA and Europe. All the primary banks saw Montesinos as the ideal private banking client, requiring discrete handling and putting the funds in the name of family members.

The exposure of the offshore centres is in their limited ability to distinguish good business from bad, risky business from safe business. And the worst cases demonstrate weakness at the heart of the supervisory structures in the advanced countries. The case of Bank of New York and its involvement with Russian organised crime and poor banking practices in Europe is an example.

It is common for major financial institutions to establish subsidiary operations in the offshore centres and to route transactions, subsequently shown to be illegal, through them. Look no further than Enron for an example.

Where offshore centres have shown their weakness is in licensing of offshore financial institutions without rigorous due diligence. In most instances where the regulatory process is weak it has attracted fraudsters

and low-level money launderers. It is possible for fraudsters to corrupt the political and regulatory process in a small jurisdiction.

In Grenada First International Bank, run by Gilbert Ziegler, effectively took control of the licensing regime. The political and regulatory structures were corrupted and numerous inadequate offshore banks were established. Nearly all the banks were merely the vehicles for simple fraud schemes that impoverished small, North American savers. Most have now been closed.

Law enforcement has not been slow to use the banking sector in offshore jurisdictions in "sting" operations, working on the basis that money launderers would flock to an apparently dubious offshore bank. In Anguilla the US and the UK cooperated to establish and operate an offshore bank intended to service Colombian drug traffickers in a scheme called Operation Dinero. The bank played a key role in the subsequent arrest and imprisonment of leading cartel members. The operation is testimony to the need that criminals have for secure banking services but it demonstrated to law enforcement the necessity for the offshore bank to have a partner entity in the USA to facilitate cash entry and provide wider banking services.

Despite the efforts of FATF, IMF-World Bank and national regulatory regimes money laundering continues apace, displaced but not deterred. In part this is due to the failure of the interdiction regime directed at the drugs trade and the growth of other forms of serious crime. But it is also testimony to the inability of regulatory mechanisms to stem crime. Financial institutions often file SAR's as a means of buying insurance against some future problem not to contribute to the fight against serious crime.

Most Currency Transaction Reports in the USA go uninvestigated. The same is true of the vast majority of Suspicious Activity Reports in other countries. An overload of information in the system is retained by the authorities largely on the basis that it might be useful to some criminal investigation at a future date. But of course it seldom is.

In general the anti-money laundering regime has made only a minor contribution to addressing the threat of serious crime. The real purpose of the anti-money laundering regime appears to be intended to make the tracing of the

financial flows easier for the investigators once the crime itself has been solved.

There is the further difficulty that the repressive anti-money laundering structures try to swim against the tide of free markets, price and profit signals. There is no extra profit to be made by establishing a vigorous compliance regime in a financial institution. On the contrary there is only extra expense, both in direct business costs and the reduction of available business.

The burden of regulation related to money laundering has reached, in recent years, to a level where business will no longer support it. The Wolfsberg Group of mainly European banks has demonstrated this point in their negotiations on recent European and FATF money laundering initiatives. In the UK the Bankers Association recently lobbied successfully on issues related to record keeping. It is clear that the increased level of anti-money laundering regulation is having a minor impact on criminal enterprise but a disproportionate impact on legitimate business.

Financing Terrorism

In the Caribbean we have seen little evidence of a flow of funds to finance acts of terrorism, despite the almost comic efforts of the US Treasury Department in their rush to judgement on accounts in the Bahamas held by New York based, Afghan originating diamond merchants in 2002.

Indeed in Europe the primary mechanism for the financing of the life style of terrorist bombers and their associates is clearly the social welfare programmes run by the state, augmented by criminal activity. Even in the US the amount of money required to finance a terrorist in the preparatory stages of an attack is so small as to be certain to be able to pass "under the radar". But what we have seen is a jockeying for a place at the anti-terrorism table by those concerned with the regulation of financial institutions, offering products that are inappropriate to the task.

Where large sums of money do flow they are not directly destined for terrorists but are defined as flowing to those who may be involved in the support of terrorists, such as schools, religious charities, Islamic welfare and legal defence groups. This broadening of the definition of the financing of terrorism only seeks to establish the credentials of those who wish to participate in the battle with their weapons of financial regulation. What

it fails to recognise is the intelligence that may be gleaned about how this supporting infrastructure is financed. Penetration, not elimination is required.

There is widespread evidence that all terrorist groups ultimately become involved in criminal acts of extortion, kidnap for ransom, fraud and bank robbery, in part to support themselves but also just because they can.

It is vital that the focus on terrorism finance does not become viewed as a specialist function in which Treasury officials alone are the gatekeepers. All aspects of law enforcement need to be involved. The issue of identifying, not denying, the financial resources of terrorists and their supporters, needs to be broadly based. And the intelligence capacity to follow these links needs to be extended. This will not be done through the financial regulatory mechanisms developed to tackle traditional money laundering.

Transparency

It is no surprise that both corruption and money laundering need discretion or better yet, absolute secrecy. The banking sector is synonymous with secrecy. Many of the problems that are related to both corruption and money laundering have their origins in secrecy. Offshore financial services jurisdiction traditionally offered confidentiality as a central feature of their marketing.

Transparency may be a partial solution to these problems of corruption and money laundering. If all public affairs were conducted in a completely open forum the scope for corruption would be reduced. If the process of award of all public contracts was displayed on the website of the public body concerned it would be more difficult to sustain corrupt practices.

Business transactions are often confidential from those in the financial sector that might be handling only part of the transaction, for example a wire transfer, on the grounds of client confidentiality. Recent efforts to require information about the sender and the recipient on a wire transfer have met with protests from some parts of the financial community. Commercial transactions flowing through the banking sector are usually anonymous. These procedures create the conditions that support "layering" in the money laundering process.

Many commercial transactions are considered confidential because the parties concerned wish to obscure their pricing policies, or more often the level of their profit margin. More transparency and openness would encourage competition and lead to lower prices, not something most monopolists want to see.

International cooperation.

In a global economy the problems of corruption and money laundering are international problems, not limited to offshore financial centres but running through the entire financial system. And of course the same is true of terrorism financing.

We have seen a growing network of international agreements designed to extend international cooperation. They all usually require the authorities in one country to carry out certain acts on behalf of the authorities of another country. And the twin issues of how timely and how effectively are the rocks on which the cooperation will flounder.

In Europe we have moved to a system where law enforcement officers can have jurisdiction across national borders. This has come from the need to keep up with criminals who are not constrained by borders. This model may be the way forward in the future and would have great relevance in North America and the Caribbean in the fight against all forms of serious crime.

Thank you for your attention.

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